

# STATE OF NEBRASKA

DEPARTMENT OF PROPERTY ASSESSMENT & TAXATION  
Catherine D. Lang  
Property Tax Administrator

July 15, 2003



Mike Johanns  
Governor

Mr. Michael A. Smith, Esq.  
Deputy Sarpy County Attorney  
Hall of Justice  
1210 Golden Gate Drive  
Suite 3147  
Papillion, Nebraska 68046-2889

RE: Offutt Housing

Dear Mr. Smith:

You have requested an opinion from this office in a letter dated June 20, 2003 regarding two issues that have emerged in Sarpy County. The federal government is seeking to privatize the function of providing housing for civilian and military personnel at Offutt Air Force Base. Previously, the housing was built and maintained by the federal government. Factually, your letter indicates that it is proposed that the Air Force will turn over the buildings and improvements to the successful bidder, who will have the right to build, operate and maintain such housing. It will retain the ownership of the underlying property but will lease the property to the bidder for up to 50 years. Title to the existing onsite improvements will be deeded to the private lessee. Therefore, if the proposal is accepted, the contractor will own the improvements and have a leasehold interest in the property. The Air Force will retain a leased fee interest. You raise two issues. The first is the question of whether locally assessed ad valorem taxation is permissible for some or all of the property interests created by the proposed agreement between the federal government and a private entity. The second relates to any potential impact that the possible taxability of some or all of the property involved would have on payments made by either the State of Nebraska or the federal government to the Bellevue Public Schools.

## TAXABILITY OF PRIVATE INTEREST ON FEDERAL LAND

Nebraska law dealing with the taxation of real property begins in Neb. Rev. Stat. Section 77-103 (Cum. Supp. 2002) which defines real property as land; buildings, fixtures and improvements; mobile homes, cabin trailers, and similar, property; mines and minerals; and all privileges pertaining to the real property described in the statute. All real property that is not exempt is subject to property taxation pursuant to Neb. Rev. Stat. Section 77-201 (Cum. Supp. 2002). In analyzing the questions of taxability arising from this project, the simplest question deals with the buildings and improvements. The contractor/bidder is a for-profit entity and not a governmental entity. It owns the buildings outright under the terms of its proposed agreement with the Air Force. As improvements on leased public land, Neb. Rev. Stat. Section 77-1374 (Cum. Supp. 2002) clearly applies. It states:

Improvements on leased public lands shall be assessed, together with the value of the lease, to the owner of the improvements as real property. On or before March 1, following any construction thereof or any change in the improvements made on or before January 1, the owner of the improvements shall file with the county assessor an assessment application on a form prescribed by the Property Tax Administrator. The taxes imposed on the improvements shall be collected in the same manner as in all other cases of collection of taxes on real property.

Based on this language, it seems apparent that privately owned improvements, even on publicly owned land, are subject to local property taxation.

The other interest in the hands of the bidder/lessee is the leasehold interest represented by the 50 year lease. Section 77-103(5) includes as real property, "All privileges pertaining to real property described in subdivisions (1) through (4) of this section." The Department of Property Assessment and Taxation, in its regulations found at 350 Nebraska Administrative Code, Chapter 10, Section 001.01 (2003) defines privileges related to real property as including the right to sell, lease, use, give away or the right to refuse to do any of those things. Among the privileges pertaining to real property are leasehold interests. The bidder/contractor has significant rights in the use of the property involved for 50 years. That interest is a recognizable interest in real property. The Nebraska Supreme Court determined that, "... the existence of a lease for years on certain property in suit herein suggests an ownership of "an interest in land" properly the subject of an independent assessment as the property of the lessee". *North Platte Lodge, B.P.O.E., v. Board of Equalization*, 125 Neb. 841, 846 (1934). The Nebraska Court of Appeals recently dealt with a question involving leasehold interests in *Omaha Country Club v. Douglas County Bd. of Equal.*, 11 Neb. App. 171 (2002). The court determined that the valuation of property must represent the value of all of the interests in the property and in determining the value of real property, "...the actual or fair market value of the real property can only be ascertained by first determining the fee simple value, including the value of the leasehold estate, the leased fee estate, and any other severed estate." 11 Neb. App. at 182, (Emphasis supplied.) A leasehold interest conferring the right to use and control property for a 50 year term has value and is taxable under Nebraska law.

Complicating matters in this situation is the remaining ownership interest in the property of the United States Government. Clearly, units of state or local government may not impose taxes on federal property without the consent of the federal government. However, the initial question presented is whether the imposition of property taxes on an ownership interest in improvements and a leasehold interest in federally owned land amounts to the imposition of property taxes on federal property or on the interests owned by a private entity. The case that would seem to have the most application to the current factual situation is *Offutt Housing Company v. County of Sarpy*, 351 U.S. 253 (1956). In that case, a private entity entered a contract with the Air Force to lease land and build a housing project on Offutt Air Force Base. The lease was for 75 years at a rental price of

\$100.00 per year. The buildings and improvements erected by the Lessee were to become real estate and part of the leased land and public buildings of the United States, leased to Lessee. When the lease expired, the improvements would remain the property of the federal government. The county sought to impose property taxes on the interest of the Lessee in the land and improvements. The Lessee sought a declaratory judgment that the tax levy and assessment were void and to enjoin the collection of taxes. The District Court ruled in favor of the Lessee but the Nebraska Supreme Court reversed at 160 Neb. 320, 70 N.W.2d 382 (1955). The case went to the United States Supreme Court, which affirmed the decision of the Nebraska Supreme Court and held that the interest of the Lessee was indeed taxable. Noting that the lease was for 75 years but the useful life of the buildings and improvements was only 35 years, the Court noted that the full use and enjoyment of the buildings and improvements would be in the Lessee. In differentiating between the interest of the Lessee and that of the federal government, the Court noted:

The Government may have 'title,' but only a paper title, and, while it retained the controls described in the lease as a regulatory mechanism to prevent the ordinary operation of unbridled economic forces, this does not mean that the value of the buildings and improvements should therefore be partially allocated to it. If an ordinary private housing venture were being assessed for tax purposes, the value would not be allocated between an owner and the mortgage company which does his financing or between the owner and the State, which may fix rents and provide services. In the circumstances of this case, then, the full value of the buildings and improvements is attributable to the lessee's interest. 351 U.S. at 261.

Although one could construe from the broad language of the Court that had the lessee in *Offutt* actually owned the buildings and improvements, that the same result would have been reached, a strictly technical reading of the case would limit its holding to the taxability of a privately owned leasehold interest in federal property.

A state case involving improvements that are owned by a private entity as well as the leasehold interest in a factual scenario that appears almost identical to the current one is *Ben Lomond, Inc., v. Fairbanks North Star Borough Board of Equalization*, 760 P.2d 508 (Alaska 1988). The United States issued a request for proposals by private developers to build 300 units of housing on Eielson Air Force Base. Ben Lomond was the successful bidder. There were two agreements: The Land Lease and the Project Lease. Under the Land Lease, Ben Lomond leased land for twenty-three years, paying one dollar in rent for the entire lease term. The parties also executed a lease back for twenty years under which Ben Lomond was the lessor and the United States the lessee for an annual rent of \$3,600,000.00. The Land Lease was authorized by 10 U.S.C. Section 2667 which, among other things, provided that the interest of a lessee of property leased under this section may be taxed by State and local governments and provided for the renegotiation of the lease if taxes were later imposed. The Project Lease was an effort to see if leasing was cost effective to the United States in providing military housing. The statute authorizing the Project Lease, 10 U.S.C. Section 2828 did not indicate an intent to superseded 10 U.S.C. Section 2667 providing for the taxation of private interests. There

were provisions in both the Land Lease and the Project Lease whereby Ben Lomond would be responsible for all taxes that could become due and payable or assessed against the premises during the term of the leases. The local assessment authority issued an assessment notice to Ben Lomond for the possessory interest in the leased land as well as the improvements on the land. Ben Lomond availed itself of the protest to protest such assessments and the case was ultimately heard by the Alaska Supreme Court.

In determining that both the leasehold interest and the buildings would be taxable to Ben Lomond, the court recognized a leasehold interest in the land and that Ben Lomond owned the buildings. With respect to the taxation of the leasehold interest, the court cited *Offutt*, noting that the Court determined the case under the predecessor of 10 U.S.C. Section 2667 and determined that Congress had consented to the taxation of the lessee's interest in the project at issue. It also noted a significant number of cases from other jurisdictions, imposing ad valorem taxes on leasehold interests and buildings constructed by private entities on federal land leased to those entities. Ultimately, the court looked at the definition of real property for property tax purposes of the local jurisdiction and plainly, buildings, structures and improvements fit one portion of the definition and the leasehold fit another. Therefore, the interests of Ben Lomond were subject to local property taxation.

The Nebraska Statutes cited earlier, regarding the definition of real property as well as the more specific statutes dealing with the taxation of improvements on leased land, would seem analogous to the ordinances cited in *Ben Lomond*. Further, the factual situation appears to have significant similarities to the present one.

In a telephone conversation, Michael Stanoikovich of MVW Development, a potential bidder, indicated that a case in Ohio had resulted in the determination that the interest of the leaseholder in property located on a military base was not subject to property taxes. In *Visicon, Inc., v. Tracy*, 83 Ohio St.3d 211, 699 N.E.2d 89 (1998), the Ohio Supreme Court determined that a hotel operated at an Air Force base on land leased from the United States Government was exempt from property taxation. There were two reasons articulated by the court. The first was that the federal government had obtained exclusive jurisdiction over the hotel, even though under the terms of the agreement between the federal government and Visicon's predecessor in interest made the private entity building the hotel the owner of the improvement. Property under the exclusive jurisdiction of the federal government is exempt from tax under the United States Constitution, Clause 17, Section 8, Article I. Second, the court distinguished that case from the case the United Supreme Court heard in *Offutt* in large measure because "...Nebraska imposed a tax which apparently reached the leasehold property." 83 Ohio St.3d at 217, 699 N.E.2d at 93. Even though federal law, in 10 U.S.C.A. Section 2667(e) permits a state to tax the interest of a lessee in such federal property, the state of Ohio, unlike Nebraska, does not impose a tax on such leasehold interests.

On the exclusive jurisdiction issue, the record in *Visicon* indicated that the land on which the hotel was located was exclusive jurisdiction land. A letter from the base commander,

a section of the lease that expressly noted exclusive federal jurisdiction and several letters between the Air Force and the governor of Ohio indicating an acceptance of exclusive federal jurisdiction by the Air Force and the State of Ohio were a part of the record. Our office has not been presented with letters such as those referred to in *Visicon*. However, in Appendix I, Lease of Property, for this project, there does not appear to be a specific provision for exclusive federal jurisdiction. Section 8.1 provides that the Lessee shall pay all taxes, assessments, and similar charges which, at any time during the term of this Lease may be imposed on the Lessee with respect to the Leased Premises. Further, Section 12.5 provides that:

Nothing in this Lease shall be construed to constitute a waiver of Federal Supremacy or Federal Sovereign Immunity. Only laws and regulations applicable to the Leased Premises under the Constitution and statutes of the United States are covered by this Condition. The United States presently exercises varying degrees of federal jurisdiction over the leased premises. (Emphasis supplied.)

There does not seem to be the same express delegation of exclusive federal jurisdiction involved in this project as was the case in *Visicon*. Further, Condition 17 deals with the Construction of Leased Premises Improvements and Alterations, in other words, the improvements on the leased land. Section 17.1 provides:

It is specifically understood that the demolition, design, construction, renovation, operation and maintenance of the Leased Premises Improvements is a private undertaking; title to the Leased Premises Improvements shall be vested in the Lessee subject to the terms of this Lease; and the Government's sole and exclusive interest and liability in this Lease is limited to that of lessor of the land.

There appears to be no grant of exclusive jurisdiction over the improvements to the federal government. Although the Lease gives the federal government a significant role in the operation of the facility, there appears to be no specific grant of exclusive jurisdiction.

The *Offutt* case did deal with the exclusive jurisdiction issue. It construed the provisions of the Military Leasing Act of 1947 and the Wherry Military Housing Act of 1949. Neither of those statutes indicate a clear intent to provide for exclusive federal jurisdiction of the military housing involved. The Court stated:

Charged as we are with this function, we have concluded that the more persuasive construction of the statute, however flickering and feeble the light afforded for extracting its meaning, is that the States were to be permitted to tax private interests, like those of this petitioner, in housing projects located on areas subject to the federal power of 'exclusive Legislation.' We do not hold that Congress has relinquished this power over these areas. We hold only that Congress, in the exercise of this power, has permitted such state taxation as is involved in the present case. 351 U.S. at 260-1.

The *Offutt* case involved the taxation of a privately owned leasehold interest in federal property. In the opinion of this office then, the privatization of the base housing at Offutt Air Force Base will create private ownership interests in real property and, based on case law and Nebraska statutes dealing with property taxation, those interests appear to be taxable. Although not specifically asked about the method of valuing such property, there is some discussion of valuing property subject to leasehold interests in the *Omaha Country Club* case cited earlier. Essentially, the property needs to be valued as if it were owned in fee simple and then apportioned to the leased fee and leasehold interests.

#### POTENTIAL IMPACT ON AID TO SCHOOLS

There is a second issue raised in your letter, namely, the impact on the Bellevue Public Schools if this property were put on the tax rolls. At the outset, it must be noted that the question of whether adding the value of the leasehold interest and the value of the improvements to the tax rolls in Sarpy County would have an impact on aid payments to a local school district would not alter the question of whether the property is taxable. Local or even state officials do not legally have the discretion to choose not to assess and tax property that is subject to property taxation. In fact, Article VIII, Section 4 of the Nebraska Constitution prohibits the commutation of taxes in any form.

Clearly, the addition of real property to the valuation base in the school district would be an additional potential source of local property taxes for the district. However, the district is concerned that an increase in property value in the district would have adverse consequences in terms of state aid to schools and federal impact aid. With respect to the state aid formula, in general, under the Tax Equity and Educational Opportunities Support Act (TEEOSA) state aid is distributed based on the concept of need minus resources equals aid. On the resource side, the local property tax base does count as a resource. One of the purposes of Nebraska's current state aid to schools structure is to ensure that real property is accurately assessed and reflects the actual property wealth of a school district. So, if the resources are increased for a school district by virtue of additional taxable real property, it could generate more money from property taxes and would potentially receive less state aid. As part of the determination of state aid to schools, a district's yield from local effort rate, amounting to a district's adjusted valuation multiplied by the Local Effort Rate of 0.95. Additions to the valuation base would be subject to that calculation.

Federal impact aid is money a school district receives from the federal government to assist it in providing a quality education for the children of men and women in the armed forces. There seem to be two methods of generating federal impact aid to local school systems. Under 20 U.S.C. 7702, federal impact aid appears to be a sort of "in lieu of" payment, meant to make up for local property tax revenue lost to local school districts when there is significant amounts of federally owned, tax-exempt property in the district. The next section, 20 U.S.C. 7703, is the section under which the Bellevue Public Schools receives federal impact aid. It provides for payment of federal aid to school districts that

provide an education to the children of people who reside on federal property or children who have at least one parent who is, "...[o]n active duty in the uniformed services.... but did not reside on Federal property" 20 U.S.C. 7703(a)(1)(D)(ii). It appears then, that a school district with a significant number of "federally-connected" children could receive federal impact aid even if property that was formerly exempt from local taxation becomes taxable. Based on discussions with Kerry Wingell of the Program Operations Group of the U.S. Department of Education Impact Aid Program Group, school districts with federally-connected children who live off of federal property still receive federal impact aid but do receive significantly less aid than if those children live on federal property. This raises the question of whether the arrangement proposed for Offutt Housing whereby the federal government would own the leased fee interest but a private entity holds title to the improvements and a leasehold interest in the land would be considered federal property for the purposes of federal impact aid. Statutorily, 20 U.S.C. 7713(5)(C) deals with easements, leases, licenses, permits, improvements, and other real property in the following manner:

C. NON-FEDERAL EASEMENTS, LEASES, LICENSES, PERMITS, IMPROVEMENTS, AND CERTAIN OTHER REAL PROPERTY--The term "Federal Property" includes, whether or not subject to taxation by a State or a political subdivision of a State--

- i. any non-Federal easement, lease, license, permit or other such interest in Federal property as otherwise described in this paragraph, but not including any non-Federal fee-simple interest;
- ii. any improvement on Federal property as otherwise described in this paragraph; and
- iii. real property that, immediately before its sale or transfer to a non-Federal property, was owned by the United States and otherwise qualified as Federal property described in this paragraph, but only for one year beyond the end of the fiscal year of such sale or transfer.

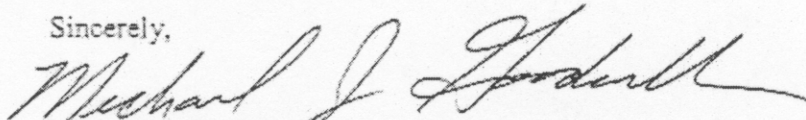
Although this office does not offer a definitive opinion on the effect of the potential taxability of the improvements and the leasehold interest of a private entity on federal impact aid, it appears that for the purposes of the federal impact aid statutes, privately owned interests may still be considered to be included in the definition of federal property. I discussed this issue with Miriam Whitney, an attorney with the Department of Education and it appears that the Department has taken the view that if the federal government still owns the underlying land, even if the improvements are privatized and a leasehold interest in the land is granted to a private entity, the Department will still treat that property as federally owned for impact aid purposes and provide payments on the higher level for federally connected children living on federal property. The school district in Alaska that receives federal impact aid that was the subject of the *Ben Lomond* case receives aid on this basis even though the improvements are owned by a private entity. There is one caveat to this: 20 U.S.C. 7703(a)5(A) dealing with military "build to lease" program housing does provide for impact aid to be reduced where certain types of privatized federal housing are generating revenue for local educational agencies through

Michael A. Smith  
July 15, 2003  
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I hope this information is of some assistance to you. If you have any questions or would like to discuss this matter further, please feel free to contact me at (402) 471-5763.

FOR THE PROPERTY TAX ADMINISTRATOR

Sincerely,

A handwritten signature in dark ink, appearing to read "Michael J. Goodwillie", written in a cursive style.

Michael J. Goodwillie  
Counsel

cc: Michael Stanoikovich  
MVW Development  
409 E. Monument Ave.  
Dayton, Ohio 45402